

July 11, 1984

LETTER 891

June 29 DJIA 1132.80; PTI 1571; A-D Ratio -21.59
June 6 DJIA 1122.57; PTI 1561; A-D Ratio -22.00

THE MARKET: Back in March I was asked by Louis Rukeyser on "Wall Street Week" what I thought the high side for the Dow would be in 1984. I answered that since this was a bear market, it was normal (during Primary bear markets) for the highs to be seen at the beginning of the year. Therefore, my guess was that the January high of 1286 would represent the high for 1984.

So far, that's been the story. The statistics for the first six months of 1984 are not horrendous, but they are nevertheless typical bear market statistics. For the first six months the Dow was down 10%, the D-J Transports were down 21%, the D-J Utilities were down 5.7%, the S & P 500 was down 7.1%, the Amex was down 10.2%, the NASDAQ Composite was down 14% and the Value Line Composite was down 11.1%. My guess still is that Dow 1286.64 recorded on January 6 will be the high for 1984.

A lot of advisories have been attempting to use cycle theory, contrary opinion, astrology, sentiment indicators and what have you—all in an effort to call the beginning of the long promised "pre-election rally." It would appear that the advisories are more anxious to catch a rally than they are to save their readers from losses in this bear market.

In the last report I noted that the market was indeed trying to rally, but that the rally was feeble. Not much has changed since then. The lows for the bear market occurred on May 29 (457.82) for the D-J Transports and June 15 (1086.90) for the D-J Industrials. Almost three weeks have elapsed since then, and the best we can say is that those lows have not been violated. On the other hand, you will note on the page 2 chart that the A-D ratio (which is a proxy for the entire NYSE) has made almost no upside progress, while my Primary Trend Index (an amalgam of eight critical indicators) is at its bear market low.

The weakness in the PTI is not a comforting situation. As I've stated many times before, a PERSISTENT downtrend in the PTI will always drag the rest of the market down with it. So far, the majority of stocks, as measured by the Advance-Decline Ratio, has been sliding with the PTI. New lows on the NYSE have consistently outnumbered new highs for months.

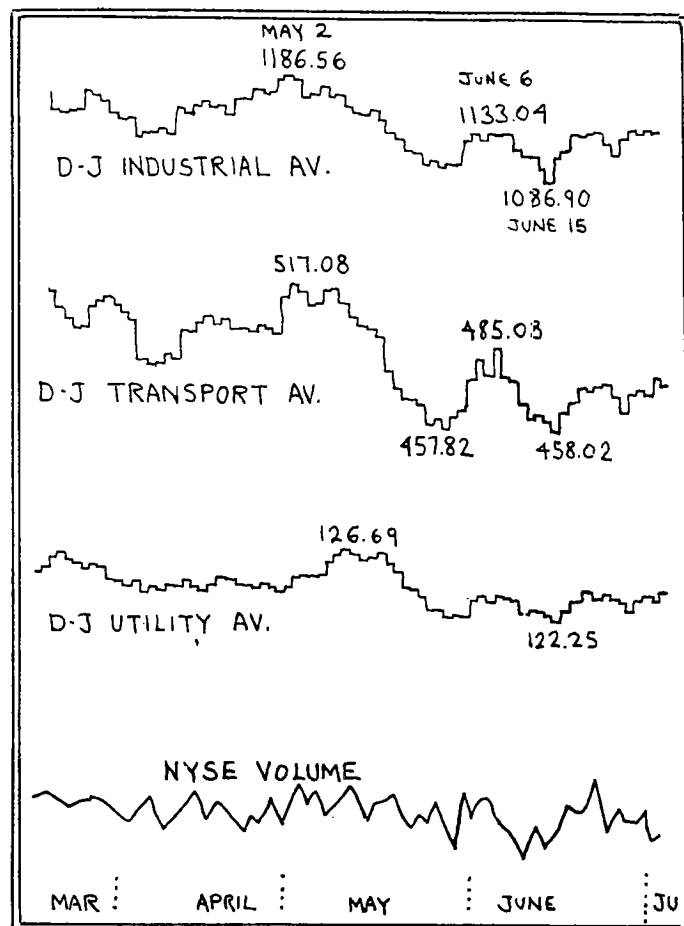
Note on the page 1 chart that on the recent rally the Dow bettered its June 6 high, closing on July 3 at 1134.28. The Transports *failed by 5 points to confirm*. This is not good action and could cause trouble in the days ahead.

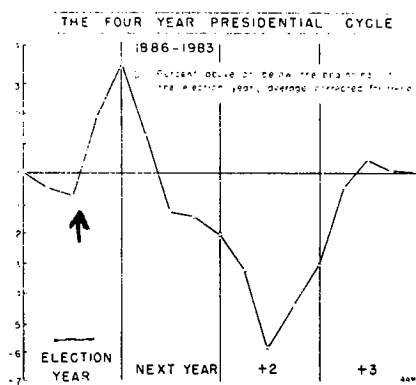
There are two items that are still positive for this market: The first is that up to now the Dow low of 1086.90 and the Transport low of 457.82 have not been violated. The longer that one or both of these lows hold, the better the chances for a rally into the summer-fall period.

The second item is that the low in the bond market which was made on June 30 has not yet been violated (see last report). If the September T-bond futures can reach 62, we will have the most hopeful bond picture in many months.

CRITICAL TEST: Everybody knows about the election year market, and how the market is "supposed" to go up at least during the second half of every election year. In case you need your memory refreshed, I include here Arthur Merrill's chart showing the average DJIA action for all the election years going back to 1886. As you can see, there is a strong tendency for the market to rise during the second half of each election year (up arrow is mine).

In the last issue my friend Ian McAvity (Deliberations) has included a tabulation of Dow action from the May-June low point to the fourth quarter high—and the tabulations go back to 1900. There has been only one decline out of 21 instances.





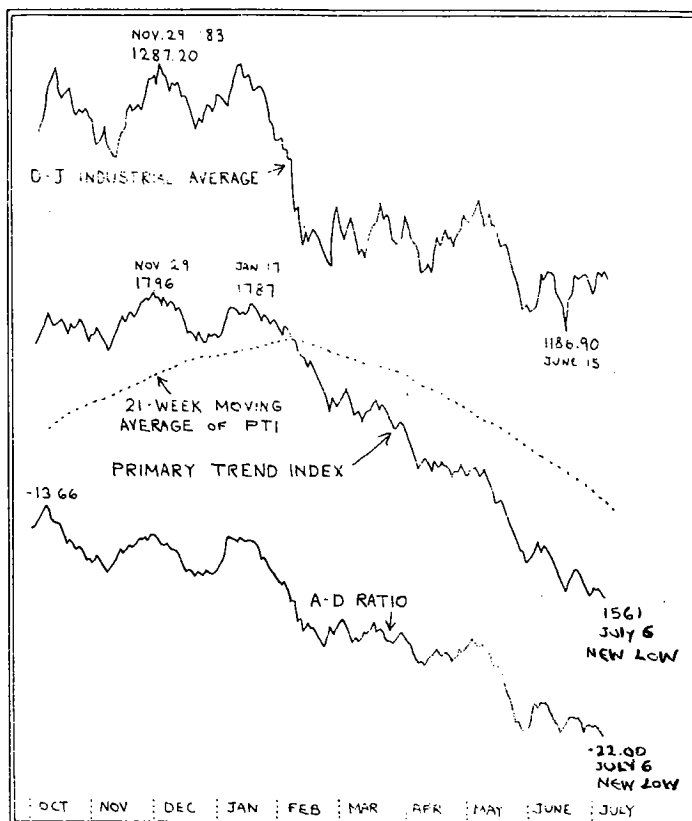
That one decline proved rather prophetic, because from the May 1920 low of 87.36 the Dow dropped 24% (in a period of seven months) to the December low of 66.75. By August of 1921 the Dow had sunk to a new low of 63.90.

The June 15 low for the Dow was 1086.90. The historical odds heavily favor a rally of some importance into the fourth quarter of this year. The June 15, 1984 low occurred following a one-year decline in the A-D ratio, which is historically a long decline.

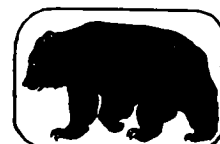
My feeling is that if the rally from the June 15 low is sub-standard or if the market goes flat or even down between now and the fourth quarter—this will be the market's way of telling us that the economy is in serious trouble. In other words, when the market doesn't do what it is supposed to do, watch out.

ELECTION YEAR MARKETS			
DJIA FROM THE MAY/JUNE LOW POINT TO THE 4TH QUARTER HIGH POINT			
Year	M/J LOW	Q4 HIGH	% GAIN
1980	805.20	1000.17	+ 12.4%
1976	958.09	1004.65	+ 4.9%
1972	925.12	1036.27	+ 12.0%
1968	891.60	985.21	+ 10.5%
1964	800.31	891.71	+ 11.4%
1960	599.61	617.78	+ 3.0%
1956	468.81	499.47	+ 6.5%
1952	256.35	292.00	+ 13.9%
1948	180.28	190.19	+ 5.5%
1944	137.06	152.53	+ 11.3%
1940	111.84	138.12	+ 23.5%
1936	146.41	184.90	+ 26.3%
1932	42.84	72.09	+ 68.3%
1928	201.96	300.00	+ 48.5%
1924	88.33	120.51	+ 36.4%
1920	87.36	85.73	- 1.9%
1916	87.68	110.15	+ 25.6%
1912	87.59	94.12	+ 7.5%
1908	69.78	88.38	+ 26.7%
1904	47.43	73.23	+ 54.4%
1900	53.68	71.04	+ 32.2%

The market rose 20 out of 21 times, from a May/June low to a fourth quarter high. The median gain was 12.4%. Of the last ten election years, the median gain was 10.9%.



INVESTMENT POSITION: The bear is very much in the box at this time. Our investment position is the same as it has been since early February, and that is **DEFENSIVE**. The most defensive of all positions is Treasury bills and /or government-oriented money market funds. I realize that not everybody can move 100% into T-bills, but you can measure your degree of total defensiveness by the percentage of your assets you have in the bills.



Remember, in a primary bear market everybody loses, but "the winner is the one who loses least." I've spent most of this year trying to persuade my subscribers about the dangers and costliness of bear markets, and why this is indeed a bear market. I feel I've done my part. But each person must kill his own snakes, and I have all I can do to kill my own.

CHEAP STOCKS? Joe Granville has often asked, "What have corporate profits got to do with the stock prices?" And he immediately answers, "NOTHING!" In one sense Joe is absolutely right. Just because you know (or think you know) what corporate profits are going to do three or six months from now—does not tell you where the market is going to be three or six months from now. And the reason is simple—no one knows with certainty how much the market has discounted what lies ahead.

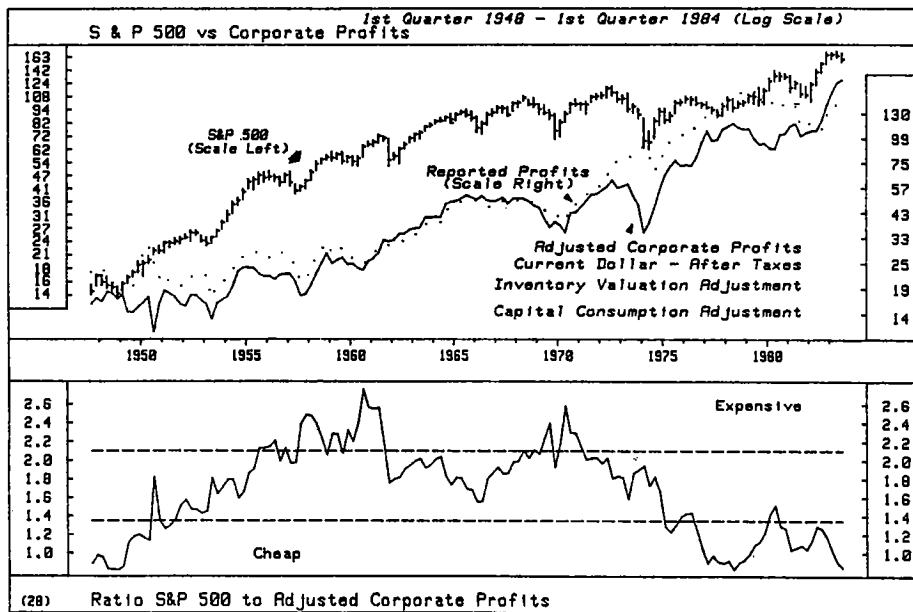
Let me give you a fascinating and very critical example. The Bank Credit Analyst and "Industry Forecasts" are both forecasting a declining rate of corporate earnings during the rest of 1984 with the latter predicting that the nation will be in recession by Christmas. State the Levys (who write Industry Forecasts): "As summer begins, worries about an over-heating economy

are still predominant. When autumn arrives, those trepidations will be gone, replaced by spreading fear of cold times ahead." I think that's clear enough, and let me add that I have a lot of respect for Tony Boeckh at BCA and the Levys at Industry Forecasts.

So let's assume that these two economists are correct in their forecasts and that corporate earnings are heading down and that a recession looms (and certainly a recession before the 1984 election would be a bit of a shocker). Wouldn't that guarantee a market collapse? The answer is, not necessarily.

I am including here a chart just published by Ned Davis (1-800/241-0621). What we see here is a two-part chart. The top section shows the S & P 500 Stock Index and corporate profits adjusted in current dollars. As you can see, the adjusted profits are at all time highs. But the interesting part of the picture is below. Here we see the S & P 500 divided by adjusted corporate profits. And lo and behold, the ratio is way down at .84, around its lowest point in history (with the exception of first half 1949 and the last quarter of 1978).

In other words, in terms of adjusted profits the S & P 500 (which is a good proxy for the entire stock market) is very cheap—extremely cheap. In fact, at a ratio of .84 the S & P would seem to have ALREADY DISCOUNTED a big slide in corporate profits.



So the question arises: given that corporate profits are heading down in 1984 (and maybe well into 1985) could not the market be at bottom already? And my answer is, "Yes, it could have bottomed. But we have to remember, this is still a primary bear market. According to Dow Theory the last confirmed trend was bear. And as long as that is the case, we have to face the probability that all surprises will occur on the downside. Regardless of P/E ratios, earnings trends, yields or technical considerations, this is a bear market and the watchword is caution."

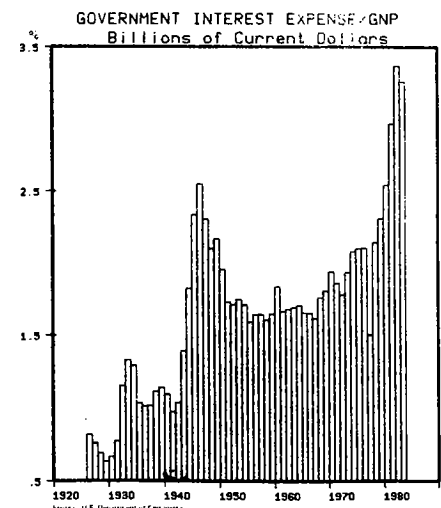
Then, there is another factor. It is true that Ned Davis' ratio is in the area where the market has discounted very poor earnings. But it is also possible that this bear market is looking at

other factors—factors besides earnings. It could be the bank situation, it could be deflation, it could be higher taxes, it could be a Reagan loss at the polls. It could be any of a hundred factors.

SECULAR CHANGE: As older subscribers know, I have taken the year 1980 as the great dividing period, a period in which the debt monster had grown so large that the very servicing of the debt began to crush the forces of inflation. The year 1980 coincided with the blow off in gold to 850, the peak in most collectible prices and a veritable explosion in US deficits and debts.

Now in 1984 we are beginning to see the things I wrote about and predicted in 1980 emerge on the political and public consciousness. In almost every magazine and newspaper (be they conservative or left-wing) we see editorials and articles about the debt and the deficits. In fact, so loud and so widespread is the public awareness of the damage caused by debt (capped by the disaster in the international banking area) that I actually believe that over the next few years we will see something done about the debt (a hint of that is in the new \$50 billion tax increase bill).

I always like to give the angel or the devil his due, and I must compliment Merrill Lynch on its extraordinary April edition of "Investment Strategy Report." In this detailed report Merrill



notes something that I have been harping on—namely that "We are in a situation in which the rate of interest at which the cumulative debt service burden is compounding is the highest growth rate in the society." They continue ominously, "The debt pyramid is growing faster than nominal GNP, personal income, corporate profits and any other component of the economy that one cares to mention."

Merrill then states that they do not believe that lenders in the future will be lending "too cheaply" or at rates below the rate of debt creation.

Merrill also states that perceptions of change dawn on the public very slowly. They think (and I agree with them) that we are

entering a long period in which the leveraged corporations and the high-debt corporations will be moving out of investors' favor while the more conservative and liquid type of corporations will be preferred. They also note that the five-year rate of growth

among US corporations is almost zero. They state that "the momentum of year to year earnings gains is slipping behind us for this cycle, and we expect that longer range forecasts will be lowered still further."

Then, the critical points: "As the inexorable demands of compound interest continue to take effect, we suspect that the next rabbit out of the hat—fiscal conservatism—will predominate in setting the secular tone of the economy."

Merrill then shows that because of an atypical 15 year explosion in debt, corporate earnings began an atypical explosion in earnings. Merrill believes that this period, due to the exploding cost of debt servicing, is over. Or, as I've said too many times in previous articles, debt creation has **REACHED THE POINT OF NO RETURN**. In my opinion, the disastrous loans to the underdeveloped nations by the banks plus the huge corporate takeover of the past year plus the leveraged buy-outs, all these constitute the final explosion in the debt picture. I think from now on we are going to see indications (and they may come slowly) of debt **LIQUIDATION** plus a rise in **CONSERVATISM**.

All of this plus the pressure on Congress and the President to do something radical about cutting the deficits should militate in favor of a longer-term rise in the bond market.

My feeling is that the bond market is scratching around for a major bottom, a bottom that could put an end to the three-decade bear market which has resulted in hundreds of billions of dollars in lost bond and mortgage values and given the US the highest real interest rates in history.

Consider this: inflation is now running at the rate of about 3% (zero over the past two months), and two-year Treasury notes are now providing yields over 13%. Money market instruments in general are now providing the highest **REAL** returns in history.

In closing this piece I want to imprint two concepts in the minds of my subscribers. (1) Forgetting new deficits, the actual cost of servicing the old debt is becoming more and more burdensome to the government. This Merrill Lynch chart shows the exploding cost of debt servicing as a percentage of GNP. If this continues, debt servicing costs will crowd out everything and the nation's economy will collapse. But happily, **RECOGNITION** of this syndrome is enveloping the nation—and I think something is going to be done about it.

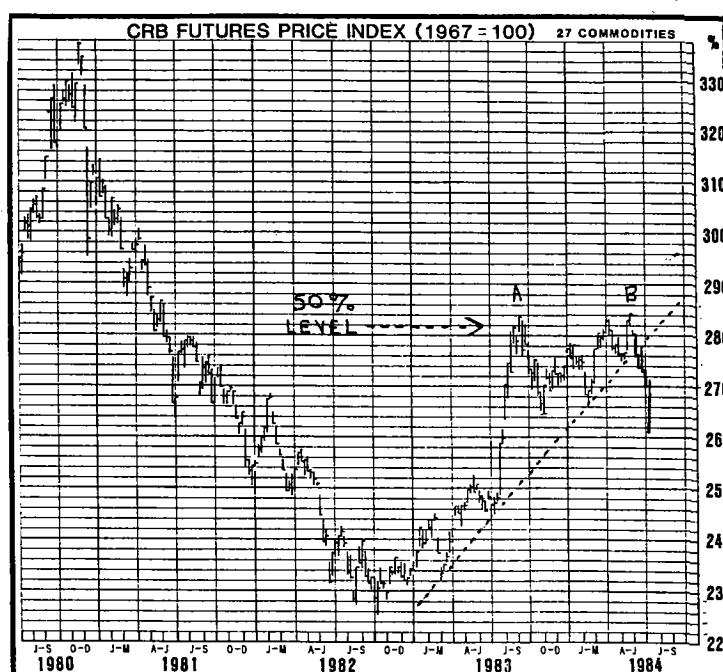
(2) The public is beginning to see the fantastic value and wealth-creating capabilities of **SAVINGS** and buying debt instruments.

COMMODITIES: I always watch the commodities, and you don't have to be a trader to see what's been happening. The grain complex has been weak with bellwether soybeans forming major descending tops. The meats (pork, cattle) have been indecisive, but I feel more bearish than bullish. The metals are bearish. World sugar has collapsed, heating oil is weak, cocoa has just broken a major rising trendline, coffee looks very topy, and the dollar continues strong (while, of course, the foreign currencies are still weak).

This chart of the widely-watched Commodities Research Bureau Futures Index (27 commodities not including gold) presents an important perspective. From late-1980 to late-1982 the Index collapsed in a major bear market. The low of 224 was hit in October 1982. From there the Index recovered roughly 50% of its bear market losses. Note the double tops marked A and B on the chart. But in June the CRB Index broke its rising trendline, and currently the Index is in the 260 area.

I consider it bearish that the Index failed to recover substantially more than 50% of its 1980-82 losses. I consider it bearish that the Index has now broken below its 20-month rising trendline.

To me, the picture is bearish and deflationary. I go along with what I feel gold is saying. The markets, as of now, **DO NOT SEE**



INFLATION AHEAD. No, my interpretation is that gold and the CRB Index are saying that the picture is decidedly deflationary.

NOTES & QUOTES: It is my humble opinion that America's mania for sports may very well top out with the 1984 Olympics. The sports mania and league competition have driven sports salaries through the roof. The NFL's average player salary has jumped 24% in 1984 over last year, mainly because of USFL competition. The NFL's headquarters told owners to expect to lose roughly \$3 million per team by 1986 as salaries per team go up from current \$10.8 million to \$20.6 million in 1986. Meanwhile, USFL owners, now losing money in most cases, debate going head-on against the NFL in the Fall of 1986. My bet—the USFL will not survive and will be disbanded or absorbed by 1987—probably before. One thing is sure—both NFL and USFL survive on TV income. The TV revenue was \$14 million per team in 1985 for NFL, \$1.5 million per year for the USFL.

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I love tidbits of wisdom from wise old investors. One of the geniuses of Wall Street is Max Heine, head of the very success-

ful no-load fund, Mutual Shares. MS, founded in 1949, has shown a compound rate of growth (dividends and capital gains reinvested) of 14%, an amazingly good record. Heine is called by some "the pioneer of bankruptcy investing," since he often buys seemingly down-and-out companies and waits for them to come back.

Recently, Heine stated that he liked Mobil Oil Corp's bonds, which currently yield about 15%. "What's the play in Mobil," a surprised newsman asked. "Nothing," said Heine, "just 15%. I shoot for objectives I am likely to achieve." In other words, if Heine's record since 1949 is 14% compounded, he likes a bond yielding 15%. It's worth thinking over in today's world of the highest real interest rates in history.

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There is one place where inflation has definitely not died. And that's in the rarefied world of art. Last week a painting by Turner went at Sotheby for roughly \$10 million, the highest price ever paid for any painting. A few days earlier the Getty museum paid \$9.2 million for a group of drawings by assorted masters and thereby paid the highest price ever for drawings. It is estimated that the Getty can spend approximately \$1 million a week for art. The reason is that this museum is the most highly endowed in the world. Last month the Getty became probably the greatest photography museum in the nation with a purchase of thousands of rare photographs at a price of roughly \$20 million.

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Michael Jackson is a new kind of performer. He was seen walking door to door last week (in disguise) talking up his religion (he's a Jehovah's Witness). Jackson is also donating all the proceeds of his multi-million dollar tour to charity. How to account for his popularity? My own opinion (aside from his talent) is that he represents a turn away from American macho. I've always felt that it's a terrific strain on a boy to act macho as so much American folklore has demanded. Along comes a guy who is sexy, but anything but macho. And the kids identify with him. Maybe it's the beginning of "male liberation" in subliminal form. The extreme of this "revolt," of course, is Boy George.

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Hamburger Thought: McDonalds accounts for 40% of the fast food business in the USA—and it has NEVER had a down quarter (earnings in one quarter lower than the previous quarter).

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The new tax bill has one dilly of a provision that few people have understood. But the change could have broad implications. The new bill hits the property seller who does his own financing or takes back a mortgage. According to the new bill, it requires the seller to charge at least 110% of the rate on a comparable maturity Treasury security. In other words, if you finance the buyer for a 20 year mortgage, you have to charge the buyer 110% of a comparable Treasury bond (which is now about 13.5) so your charge to the buyers would be around 14.85%! Under those conditions the sale is probably not going to go through or the buyer is going to want a cut in the price of your house. With home sales now falling, this new bill could be the straw that breaks the house's back.

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Oil and gasoline prices have been sliding along with precious metals and the rest of the commodity complex. This little squib from the NY Times tells us about it and again let me say, "This ain't inflation."

By STUART DIAMOND

Gasoline and oil prices are unexpectedly dropping, with retail gasoline prices at their lowest Independence Day levels in five years.

The declines, which began in late May, are as much as 8.5 percent for wholesale unleaded gasoline. They are continuing even as consumption is rising and fighting continues in the Persian Gulf, factors that would ordinarily cause prices to rise.

Industry newsletters use stronger terms. Platt's Oilgram recently called the situation a "price collapse." Petroleum Intelligence Weekly said there was "no bottom in sight" to declines on

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It's true of a few Republicans and almost all Democrats. Their heart's in the right place, but their brains aren't. The Dems have been great at starting programs for everyone, but they are terrible at figuring where the money is coming from (actually, they just figure it will come from "business and the rich"). But Senator Tsongas, he's been thinking. And by Gad, he's got some good insights. Here they are:

Part of the reason that I think the Democratic Party is in trouble in the country — and I have been saying this for a number of years now — is that fundamentally the Democratic Party is very good on issues of justice, social justice, that kind of thing, and very good on the issues of war and peace. When those are the issues before the country, Democrats generally prevail. The weakness that we have is that we, as Democrats, have never convinced the country we know how to run the economy; that Democrats are viewed as people who care less about how well the economy is doing and spend all of their time worrying about how you distribute the golden eggs. The goose's health is irrelevant. There is somehow some kind of tooth-fairy view that the economy will do well no matter what happens. And there is a basic disrespect for Democrats.

You know, the funny thing about it is, we deserve it, because it is true.

When I was on the House side, I remembered that the late Bill Steigers had an amendment that dealt with the capital gains tax, reducing it. I voted against it. Do you know why I voted against it? Because I was a Democrat. I considered the ethic in the House among my fellow colleagues that this was pro-business and, therefore, since it is pro-business we are against it. So I voted against it. That bill which I did not support did more for the economy of my state than anything I did as a Congressman.

Senator Paul E. Tsongas, Democrat of Massachusetts, in remarks on the Senate floor, May 1, 1984.

LATE NOTES: The market closed the week (week ending July 6) with the PTI at a new low (see page 2 chart). But the Averages (and I'm talking about the D-J Industrials and Transports) have still not broken below those 1984 lows of 1086.90 and 457.82. Until they do, there is hope that a rally will get underway. And despite rough interest rates, the D-J Utility average has not broken below its June low of 122.25. Watch those three levels. They are the key to whether the market is going to follow the PTI or not. Of course, the new lows in the PTI are bearish, but the Averages must confirm.

GOLD, PRECIOUS METALS: It hasn't been easy being a bear on the precious metals after being bullish on them for twenty years (up to 1980). But I call 'em as I see 'em, and I have stuck to my opinion that gold entered a primary bear market following the 1980 blow off, and I'm still of the opinion that gold and the precious metals are in a primary bear market.

I know that most of my friends in the industry and certainly 95% of the hard money camp (with the exception of C.V. Myers) are waiting for the return of inflation. Maybe inflation will return (I sure don't see it yet), but if and when it returns I hope to alert my subscribers to that fact. Then we'll do something about it. Right now, the inflationists are going through their Baptism of Fire, and it isn't going to be pleasant.

Significantly, I have not this year (for the first time since the early 1970s) been invited to speak at any of the major hard money seminars. I guess my warnings about precious metals (warnings I delivered in 1981, 1982 and 1983) were not the kind of items the hard money boys wanted to hear in 1984. Contrary opinion is interesting when things are going your way. When contrary opinion turns into fact it becomes hard to listen to and even harder to stomach.

So how do I describe last week? I guess I can start by saying that if you like deflation, you loved last week's action. The CRB Commodity Index broke down completely, and gold did what I've been warning all year that it might do. Gold smashed below the 350 level, then dropped (on June 6) below 340! You can see this big, important break on the accompanying point & figure chart (chart courtesy of Chartcraft, Larchmont, NY). My feeling is that last week's break can easily take gold down to the major support area around 300.

Silver, palladium, platinum, they all fell with gold as did most of the commodity complex from the grains to oil to lumber. If inflation is in the wind, I don't see it in the commodity charts, and if inflation is coming up that is where the early signs should appear.

As I warned might happen, the gold stocks panicked down last week with the listed golds hitting new lows and many of the South African shares dropping anywhere from 10% to 25%.

Most incredible to me has been the widespread, stubborn bullishness (regarding gold) and the unshakable opinion that inflation was "coming back BIG" in late-1984. It's almost as if the hard-money people have been blinded by hopes and wishes and as if they have become immune to reality. In over a quarter century of writing these reports I don't think I've ever seen such implacable pride of opinion as has enveloped the hard money people.

Actually what has happened is that most of the hard money people have a total vested interest in gold and inflation. Many publish hard money news letters, and it always is very dangerous to publish a report that is based on a single fixed viewpoint and a single approach to financial survival.

The investment business is a changing business and what is intelligent and even brilliant one year can be stupid and disastrous the next. Thus, while it was brilliant to own gold during the seventies, it has been disastrous to hold gold during the period following 1980. The markets hate a fixed opinion, and they hate the person who "knows" what has to happen. Maybe that's the lesson in gold here in 1984. The market can do anything, and despite the fact that "inflation was in the bag" for 1984-85, gold has collapsed.



NEXT MAILING July 25, 1984

As I see it, there have been three major distribution areas for the gold bull market, and I have marked them on the weekly chart. The third (C) and most recent distribution started in mid-1982 and carried through all of 1983. This is the third phase of the gold bear market, and it should shake out all the final stubborn gold bulls. How far will gold go in this final phase? I don't know and nobody else does either. But I would think that gold could go below 300, and perhaps substantially below 300.

